ISSUES Reliability and the Future of Transmission Costs

Transmission Business Line Expenses

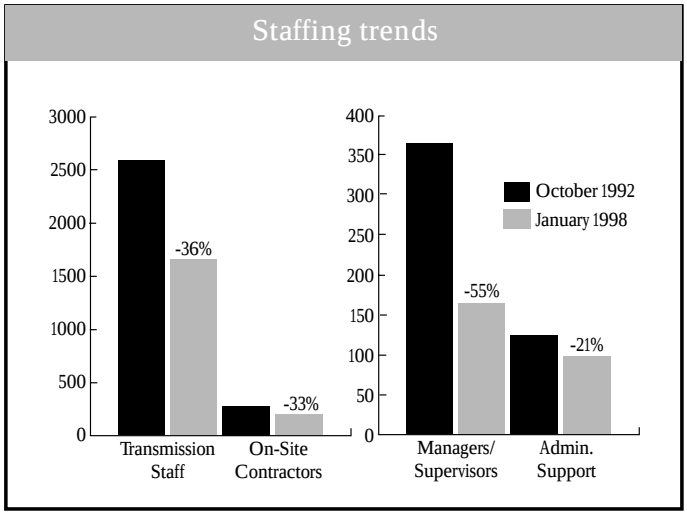
Bonneville Power Administration's Transmission Business Line has made a major effort to cut costs in the last six years, while maintaining high standards for reliability and customer service. In the midst of reducing costs, it pledged in the 1996 rate case to hold rates flat for five years. However, TBL is a very different organization from what it was in 1996. That was before TBL's separation from the power marketing function of BPA. BPA did this to be consistent with orders 888 and 889 from the Federal Energy Regulatory Commission. Separation incurred significant costs. The largest increases for the next rate period - fiscal 2002-3 - involve staffing costs and the cost of assigning some activities from BPA's Power Business Line to the TBL.

While not part of the fiscal 2002-3 transmission rate case, this discussion of what TBL is spending on its programs will inform the rate case. TBL invites your comments, and suggest that you consider the following questions:

- Are there areas where TBL should be spending less or spending more?
- Do the programs address your needs?
- Has TBL found a good balance between managing costs and the need for reliability and open access?

HISTORY - REENGINEERING

The Energy Policy Act of 1992 set the stage for deregulation and open access transmission. The need to be a low-cost transmission provider in an increasingly competitive marketplace drove TBL to reduce such expenditures as maintenance costs, staffing and overhead. The number of staff dropped 36 percent, from 2,598 employees in 1993 to 1,665 employees in 1998, with the number of managers and supervisors declining by 55 percent. Layers of management were cut from five to three. Support staff fell 21 percent. Operations and maintenance staff dropped as much as 37 percent.

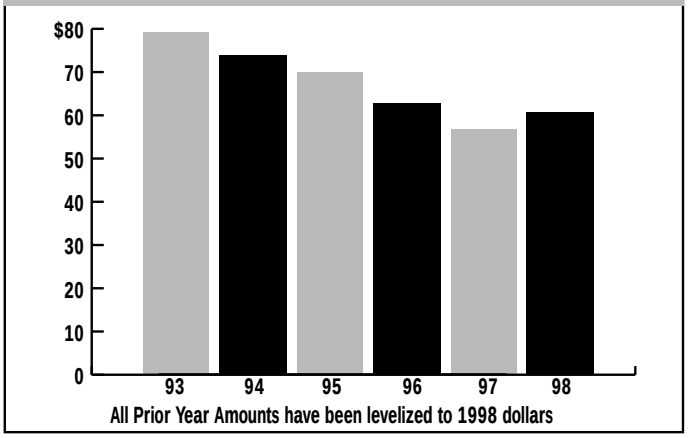


TBL also reduced labor costs through a change in maintenance philosophy. It changed from a planned preventive maintenance system where maintenance is performed whether it's needed or not, to a reliability-centered maintenance philosophy that looks at how critical a piece of equipment is and at indicators that tell when that equipment could fail.

TBL will take written comments on "Reliability and the Future of Transmission Costs" from Nov. 15 to Dec. 20, 1999. Send comments to: P.O. Box 12999, Portland, OR 97212 or e-mail to comments@BPA.gov. For questions on sending your comments, call: (503) 230-3478 (Portland) or 800-622-4519.

BONNEVILLE POWER ADMINISTRATION

System maintenance direct expense history
($ in millions)



Minimum crew sizes for electrical field workers have and will continue to save TBL money. Minimum crew size is based on the number of people needed to respond to normal anticipated emergencies and to accomplish a base level of work.

With all these changes, the cost of maintaining the system dropped by $22 million, from $80 million in 1992 to $58 million in 1997. These savings were realized in spite of the decrease in capital expenditures over the same time that typically would result in increased maintenance costs.

SEPARATION

When TBL separated from the PBL, staff, equipment, building, information resources, and other costs previously charged or allocated to organizations other than Transmission in 1996 were shifted to TBL when it became a separate business line. TBL has had to create its own billing function to bill for transmission services. Transmission scheduling was created and has expanded due to huge increases in the volume and complexity of transactions. Account executives were brought on board to act as liaisons with customers and to facilitate better communications. Separate strategy, financial and support functions were created, just as any business unit within a corporation would do.

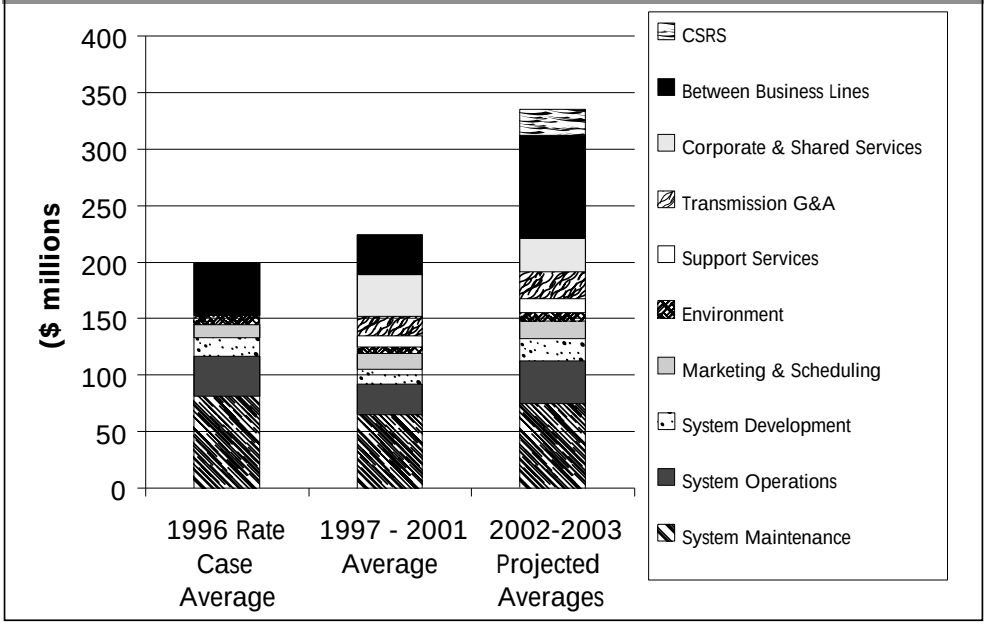
WHY ARE EXPENSES GOING UP?

About one-half of TBL's roughly $560 million in annual costs for the current fiscal year are fixed, including interest and depreciation. These expenses change only to the extent that new plant is added in the capital program and existing plant is depreciated. Of the remaining variable expenses, about 60 percent are labor costs. Key pieces are described below.

The average annual expenses forecast for the 1997 to 2001 rate period totaled $200 million. With about half of the rate period complete, TBL expects the five year average to be about $25 million higher per year. For the next rate period, fiscal 2002-3, expenses increase to $322 million per year. The two most significant areas of increase are between business lines expenses, at an average annual expenditure of $84 million, and the civil service retirement system expense, which will average $23 million per year.

- Between Business Line Expenses. These costs are primarily the generation inputs for ancillary services. That includes paying the PBL for generator-supplied reactive power and spinning reserves in order to keep electricity flows

Rate Case vs. Today vs. Projected



on the grid in balance. These costs are not new. They simply are being assigned from PBL to TBL. "Between-business-line" expenses are being addressed in the PBL subscription rate case now underway.

- Civil Service Retirement System. The federal Office of Management and Budget recently required BPA and other federal agencies to fully fund their employee pension programs. OMB allowed BPA to delay paying some of the costs of the current 1996-01 rate period into the next rate period. Therefore, the rate period fiscal 2002-3 requires additional funding to catch up on its obligations. Costs are expected to drop in future years.
- Impacts of Inflation on Personnel Compensation and Benefits. With 80 percent of Northwest transmission capacity, over 15,000 miles of lines and a workforce of nearly 1,700 people, labor costs account for roughly 60 percent of TBL's variable expenses. Over half of the staff are field employees spread out across 300,000 square miles. Their primary job is to keep the lights on.
- Succession Planning. When TBL was downsizing, it wasn't able to replace all the skilled labor it was losing. Complicating this is that in the near future, nearly one-half of the TBL labor force will be eligible for full or early retirement. TBL is now looking at whether it has gone too far in decreasing its labor force. Succession planning is being used so that in the future TBL will have as well-trained a labor force as it does now. It includes such things as replacing the highly skilled professional employees that will leave TBL in the next five years and increasing the size of the apprentice program. TBL has already increased apprentices from 34 to 53 in the past 2 years. An apprenticeship takes four years and costs nearly $100,000 per year per employee.

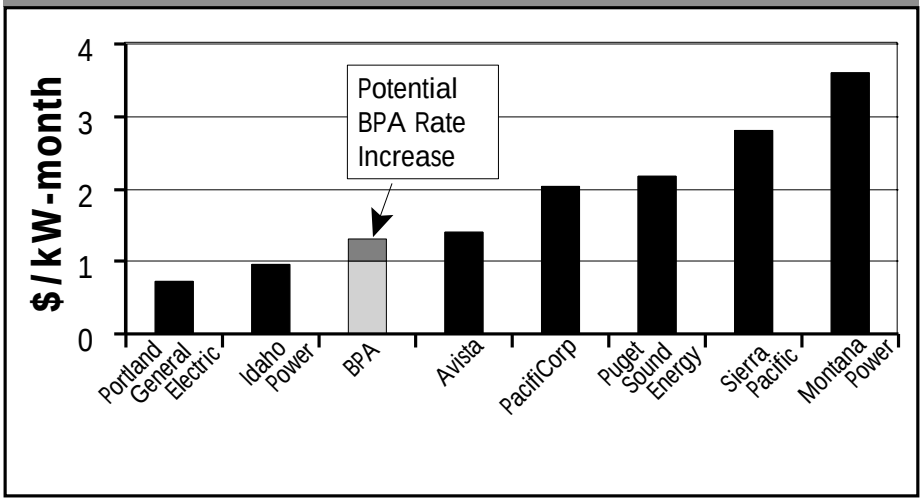
IMPACTS OF THE PROGRAM LEVELS

In previous meetings, TBL has alerted customers that separation from BPA's power function and changes in its structure may increase transmission rates for fiscal 2002-3 by as much as 20-40 percent. TBL is now the third lowest-cost transmission provider in the Northwest. Even with an increase, it will still be a low-cost provider. The actual rate level will be determined in the transmission rate case. Workshops are now underway, and the initial proposal will be made in March 2000.

RELIABILITY, OPEN ACCESS AND THE FUTURE OF TRANSMISSION COSTS

TBL is continuing the initiatives begun in 1992. While reengineering is complete, continuous process improvement is now part of the culture. In addition, TBL is installing new enterprise business systems that will help better manage costs and operate more efficiently. Approaches such as activity based costing will be used to hold managers accountable for the results expected and the resources used. New billing and scheduling computer systems, currently on order, will allow that work to be done more efficiently as well as meeting the requirements of the deregulated marketplace.

Rates: Regional Comparisons



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